

## **Senate Bill 220 Highlights**

(Version as Passed by the Senate)

### **What the bill does:**

**Tax Policy: SB 220 provides a \$30 million per biennium long-term business equipment tax cut for Montana businesses financed by asking non-residents and out-of-state-companies to pay taxes they owe to Montana.**

This legislation moves to nearly 80% the share of small businesses removed from the business equipment tax rolls by action of the 2005 and 2007 Legislatures. The revenues from non-residents and out-of-state companies are taxes owed, but not paid due to either tax neglect, improper income shifting to other states or tax evasion.

The bill achieves a long-term business equipment tax cut for Montana businesses by exempting the first \$80,000 of market value of class 8 property. This step removes approximately 10,800 small businesses from the tax rolls, and cuts business equipment taxes for another 6,500 businesses. The current market value threshold is \$20,000. (Note: the increase of the threshold to \$20,000 in 2005 removed 13,200 businesses from the tax rolls) *(Class 8 Property Exemption – Section 24)*

The bill establishes reporting mechanisms for taxpayers and tax advisors who have used abusive tax avoidance transactions. Non-residents and out-of-state companies used these shelters to evade Montana taxes. *(The Reportable Transaction Act – Sections 1 through 7)*

The bill requires taxpayers conducting business in the state and one or more other states to file an informational report with the department. Many out-of state companies tell one state one thing and another state another about the same tax facts in order to improperly shift income among the states to reduce their tax liabilities. *(Compilation of State Tax Return Data Act – Sections 8 through 13)*

The bill provides for a voluntary compliance program that allows taxpayers to voluntarily come forward and pay tax due to avoid disclosure penalties under the abusive tax shelter provisions. (*The Act for Tax Evasion Transaction Voluntary Compliance Program – Sections 14 through 16*)

The bill provides for a system of non-resident withholding for sales of Montana real property. Non-residents file and pay income taxes on the gain on the sale of property only 30% of the time, whereas Montana residents do so at a 97% rate. (*Montana Real Estate Backup Withholding Act – Sections 17 through 22*)

### **Class 8 Property Exemption**

This bill amends 15-6-138 to increase the personal property exemption from the first \$20,000 of market value to the first \$80,000 of market value from property taxation. Business owners with statewide aggregate business equipment value under the threshold are exempt from taxation on this equipment. Under the current law's \$20,000 exemption threshold, 17,328 business owners pay taxes on business equipment.

By raising the threshold to \$80,000, an estimated 10,800 small businesses would no longer pay taxes on Class 8 equipment. These businesses are in addition to the 13,200 removed from the tax rolls in 2005. This proposal combined with the 2005 action will exempt nearly 80% of the businesses in the state from the business equipment tax. This legislation will provide \$30 million per biennium in long term property tax reduction.

### **The Reportable Transaction Act**

The purpose of this act is to establish a reporting requirement for those individuals and entities that have used or sold an illegal tax shelter to evade taxes.

**The Problem:** High net worth individuals and large corporations have used abusive tax shelters and other illegal tax evasion schemes to avoid paying the appropriate amount of state and federal income tax. Almost no Montana residents or businesses or their tax advisors have been involved in abusive tax shelters. Non-residents and out-of-state corporations doing business in Montana, in contrast, have used such shelters to evade Montana taxes.

**The Solution:** This bill is based on primarily on a proven federal law as adapted to state use as recommended by the Multistate Tax Commission. The bill in large measure simply provides for a dual reporting mechanism and penalty provision to assist in ensuring compliance. Reports are required of taxpayers who used abusive tax shelters, as a cross-match, and those who promoted them. Individuals, however, are required to disclose only federal abusive tax shelters—and not any of the possible state abusive tax shelters.

The state needs its own law because the IRS does not systematically share information on abusive tax shelters for non-residents or out-of-state companies. So the practical effect of the law is to curb tax evasion by non-residents and out-of-state companies.

### **Compilation of State Tax Return Data Act**

This act will require companies conducting business in Montana and one or more other states that are to file informational reports about how they file with other states if the companies are

- required to file a federal M-3 (companies with more than \$10 million in assets)
- subject to allocation and apportionment and
- have a Montana apportionment factor of less than 20% (that is they do more than 80% of their business outside Montana),

**The Problem:** Some multi-state taxpayers report differently to states that have similar reporting requirements and tax laws. The discrepancy in reporting by taxpayers is made for tax minimization purposes only and borders on the line of fraudulent reporting. Taxpayers can report differently in states with similar tax laws with virtually no consequence of the reporting discrepancies being found by the states. States have no efficient way of verifying this discrepancy in reporting.

**The Solution:** Require multi-state corporations which meet certain requirements to file an information report with the department. The information report will give the department the necessary information to identify inconsistent reporting positions in the states where the taxpayer files. This information will enhance the department's compliance efforts directed at multi-state corporations.

#### **The Act for Tax Evasion Transaction Voluntary Compliance Program**

If a taxpayer that took advantage of one of the identified abusive tax shelters by the IRS or by Montana, the taxpayer can come to the department on their own volition in order to become compliant with Montana's tax laws.

**The Problem:** The department will invest significant resources in identifying and bringing into compliance taxpayers that have taken advantage of abusive tax shelters.

**The Solution:** The bill provides for a voluntary compliance initiative that will allow taxpayers that took advantage of these abusive tax shelters to come forward and report the use of the tax shelter on their own. For the taxpayer to be eligible for the program they must come forward between September 1 and December 31 of 2007. If a taxpayer does elect to participate in the voluntary compliance program the department can waive all of the new disclosure penalties enacted by this bill. Voluntary compliance programs have proven to be effective in other states in bringing non-compliant taxpayers into compliance.

### **Montana Real Estate Backup Withholding Act**

The bill will require a withholding for nonresidents selling Montana real property. Thirteen other states have some form of nonresident withholding for real property.

**The Problem:** Many nonresidents selling Montana real property fail to file state tax returns and pay taxes on profits from these sales. A department study found approximately 70% of nonresident sellers of Montana real estate fail to pay income tax owed on the sale of property. The department estimates that the amount of tax not being paid is more than \$11 million per year.

**The Solution:** Applying a withholding requirement would prevent nonresidents from escaping taxation on profits earned from the sale of Montana real property rightfully taxable. The bill requires a withholding from the proceeds of the sale in the amount of the lesser of 2.5% of the sales price or the amount of the certified taxable gain multiplied by the highest appropriate tax rate.